

BEFORE THE DIRECTOR OF THE DEPARTMENT OF FINANCE  
OF THE STATE OF IDAHO

STATE OF IDAHO, Department of Finance,  
Securities Bureau,  
Complainant,

vs.

CAPITAL FINANCIAL GROUP, INC.,  
Respondent.

Docket No. 2006-7-07

AGREEMENT AND ORDER

The Director of the Department of Finance has instituted an investigation into the conduct of Respondent. Pursuant to said investigation it appears to the Director that violations of the Idaho Uniform Securities Act (2004) Code 30-14-101 *et seq.* have occurred. The Director and Respondent have agreed to resolve this matter without a public hearing or other adjudication of this matter. Therefore, the Director deems it appropriate and in the public interest that this Agreement and Order be entered, and the Respondents consent to the entry of this Agreement and Order.

RESPONDENT

1. Respondent has been registered as an investment adviser with the Department of Finance since June 7, 1993.

2. On December 15, 2005, the Complainant conducted a routine examination of Respondent's office located at 2399 S. Orchard Street, Suite 206, Boise, Idaho. During the examination, Complainant noted substantial compliance deficiencies with regard to the recordkeeping requirements of investment advisers. Certain deficiencies in the areas of written policies and procedures and client agreement disclosures were also documented within the February 10, 2003 examination findings letter, however, remained uncorrected. Findings from a subsequent examination conducted on January 31, 2006

indicate missing client contracts, insufficient suitability information and financial solvency concerns that remained uncorrected.

3. As of March 1, 2006, Respondent asserts it has taken significant steps to correct the deficiencies noted by the Department.

#### FINDINGS OF FACT

4. Complainant's examination revealed that Respondent had failed to develop and follow internal policies and procedures for use in conducting its investment advisory business. The Procedures Manual was inadequate concerning annual delivery of the privacy policy, personal account trading practices, proxy voting responsibilities, code of ethics and there was no evidence of an annual review. The client agreement lacked adequate disclosure concerning the advisory fee and right of termination. The client's lack of disclosure of the right of termination was cited in the previous examination letter dated February 10, 2003.

5. Respondent failed to maintain written client agreements with respect to approximately 50% of Respondent's clients. Findings from the December and January examinations evidence shortfalls in the execution and retention of written client agreements. This finding was also cited in the previous examination letter dated February 10, 2003.

6. Respondent failed to maintain adequate documentation to establish client suitability with respect to approximately 50% of Respondent's clients. Complainant's examination noted that Respondent's files frequently were missing signed, completed, and/or current suitability information.

7. Respondent failed to demonstrate financial solvency during the examination. Complainant required a year end CPA reviewed financial statement to demonstrate financial solvency by January 31, 2006. Respondent provided a CPA compiled financial statement dated December 31, 2005, which reflected a positive net worth, however, later admitted this statement incorrectly stated a positive net worth. Respondent also admitted that liabilities had historically been understated as a result of bookkeeping errors discovered by Respondent's CPA prior to 2005.

## VIOLATIONS

8. IDAPA 12.01.08.105.04 of the Rules pursuant to the Idaho Uniform Securities Act (2004) (IUSA) requires every investment adviser to establish, maintain and enforce written procedures in compliance with CFR 275.206(4)-7 under the Investment Advisers Act of 1940. Respondent failed to maintain and enforce written compliance procedures with respect to some of its clients and is therefore in violation of Rule 105.04.

9. IDAPA 12.01.08.093 of the Rules pursuant to the IUSA requires every investment adviser to make and keep true, accurate and current books and records in compliance with 17 CFR 275.204-2. Complainant addressed specific shortfalls within an examination findings letter mailed to Respondent on December 22, 2005. Respondent failed to establish a code of ethics, disclose proxy voting responsibilities, and maintain evidence of an annual compliance review. In many instances client written agreements and suitability information was missing. Internal policies and procedures, supervisory reviews, unsigned client agreements and the missing right of termination disclosure were ongoing deficiencies that were previously noted in the Departments February 10, 2003 examination findings.

10. IDAPA 12.01.08.094 of the Rules pursuant to the IUSA sets forth the required contents of the client contract. Respondent is in violation of Rule 094 for failure to disclose information to its clients concerning the client's right to terminate the contract, and the fees to be charged to the client. Reference to a failure to disclose the client's right to terminate the contract was also included in the Department's December 22, 2005 and February 10, 2003 examination letters. As of January 31, 2006, these issues were uncorrected. Respondent asserts these issues have been corrected as of March 1, 2006.

11. Section 30-14-412(d)(7) of the IUSA provides grounds for revocation in the event an investment advisory firm is found to be insolvent. At the time of Complainant's examination the Firm was insolvent. On January 13, 2006, the Firm was solvent.

12. Section 30-14-412(d)(1) of the IUSA provides grounds for discipline/revocation in the event that materially false or misleading information was provided to the Department. The investment advisory firm provided a year end financial statement that was false and misleading. The investment advisory firm remained

insolvent as of December 31, 2005. Based on Respondent's verbal representation, the required capital infusion was made on approximately January 13, 2006.

13. Section 30-14-412(d)(2) of the IUSA provides grounds for discipline/revocation in the event the investment advisory firm willfully failed to comply with the IUSA or a predecessor act or rule. The investment advisory firm failed to correct violations cited in Complainant's February 2003 examination and December 2005 examination. Respondent asserts it has now taken significant steps to correct the violations cited in the February 2003 and December 2005 examinations.

14. Section 30-14-506 of the IUSA concerns misrepresentations regarding the investment advisory firm's registration. The investment advisory firm made a false filing as to its financial statement. However, an accurate filing was subsequently submitted.

#### **REMEDIES**

15. Respondent agrees to comply with all the provisions of the IUSA and Rules promulgated thereunder in the future.

16. Respondent admits the respective violations contained in the Order.

17. Respondent agrees to bring his investment advisory activities into substantial compliance with the IUSA and promulgated Rules by April 15, 2006.

18. Respondent agrees to remit a fine of \$1,000 to the Complainant within thirty (30) days of the date of this Order.

19. Respondent acknowledges and agrees that the violations contained herein may be used by Complainant against Respondent in subsequent proceedings in the event that Respondent violates this Order in the future.

DONE AND DATED at Boise, Idaho this 19<sup>th</sup> day of April, 2006.

BY:

NAME:

Title:

Richard R. Harrison  
RICHARD R. HARRISON  
PRESIDENT

Marilyn T. Chastain

MARILYN T. CHASTAIN  
Bureau Chief, Securities Bureau  
Department of Finance  
State of Idaho

IT IS SO ORDERED This 24<sup>th</sup> day of April, 2006

Gavin M. Gee

GAVIN M. GEE  
Director of Finance

